

**FISCAL YEAR 2010
REPORT**



**Prepared by
Department of Administration
DIVISION OF RISK MANAGEMENT**

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Mission Statement

“To effectively mitigate the State of Alaska’s risk of financial loss by educating, protecting and defending state employees, assets and operations from injury and physical damage caused by fortuitous loss.”

Objective

To protect the financial assets and operations of the State of Alaska from accidental loss through a comprehensive self-insurance program for normal and expected property and casualty claims of high frequency and low severity combined with high limit broad form excess insurance protection for catastrophic loss exposures.

Operations

Risk Management administers the self-insurance program for each State agency, covering all sudden and accidental property and casualty claims. Annual assessments allocated by Risk Management are the maximum each agency is called upon to pay, forestalling the need for supplemental appropriation or disruption of vital state services after a major property loss, adverse civil jury award, or significant workers’ compensation claim.

With a present staff of five—Risk Management operates from the State Office building in Juneau—serving a statewide constituency that includes all departments of the executive, legislative and judicial branches of state government; all state boards and commissions; their respective employees and members. The state risk management program affects many Alaskans, from the injured state employee, to those who contract with state agencies (construction, purchase, professional service and lease agreements), and all Alaskans that claim the state is legally liable for their individual property damage or personal injury.

By effectively managing the state’s property and liability exposures through a comprehensive self insurance program — Risk Management expends less public funds than would be paid to private insurance companies — providing streamlined claims services utilizing professional adjusting firms located throughout Alaska and when necessary, in house defense counsel assigned from the special litigation (torts) section of the Department of Law.

PROGRAMS

1) Insurance Administration

Property insurance with broad form all risk coverage (including earthquake and flood) is provided on a replacement cost basis covering all state owned or leased real property (buildings and its equipment) and state owned personal property (business equipment and office contents including State Museum fine arts), as well as all owned and non-owned aircraft, watercraft (Alaska Marine Highway System ferries and other agency vessels), and a schedule of large highway bridges.

Casualty coverages protect each state agency and their personnel from third party civil (tort) liability claims alleged to have arisen from combined liability; general (premises/operations), automobile, professional (errors and omissions), medical malpractice, aviation (aircraft and airport) or marine (crew and passenger injuries).

Specialty coverages — blanket public employee faithful performance and custom bonding, accidental death and disability (including medical expenses) for volunteers, computer and telephone fraud and foreign liability, etc. The State's excess insurance programs continually evolve — responding to new State activities, policy form offerings and current condition in world reinsurance markets.

In FY2010 the state continues to completely self-insure all statutory workers' compensation claims as an authorized self insured employer. The state also self insures all of its comprehensive casualty exposures; general liability (premises and operations), professional liability (medical and legal malpractice) and automobile liability. The following policies have Self-Insured Retention (SIR) levels. SIR's are the funds Risk Management contributes to a claim prior to excess policies taking effect. Property risks are still at a SIR of \$1 million per claim; for marine hull risks the SIR has been reduced from \$1 million to \$750,000; and \$250,000 per incident for airport and aircraft liability exposures. Policy limits of excess insurance vary by risk; \$500 million for marine (increased from \$50 million); \$200 million for property (excluding quake and flood) and \$500 million for airport. The following **exhibit** provides a brief overview of the FY2010 excess insurance program.

Many diverse domestic and international insurance companies and various Lloyd's of London underwriting syndicates and companies participate in the State of Alaska's excess insurance program.

Marketing of the State's insurance program is provided by Arthur J. Gallagher Risk Management Services and, Wells Fargo Insurance Services, Inc. for aviation risks, two of the largest independent brokers in the world market. The State obtained the independent actuarial assessment of the state insurance program required by AS 37.05.287 (b) from Advanced Risk Management Techniques, Inc (ARM Tech). Specialty computer software programs were

supported by CSC Consultants. All Risk Management professional service contracts are solicited through formal request for proposals issued every three to five years.

FY2010 PROPERTY/CASUALTY PROGRAM

<u>COVERAGE</u>	<u>SELF-INSURED RETENTION</u>	<u>LIMITS OF INSURANCE</u>
PROPERTY — all risk owned/leased buildings incl. contents and museum fine arts replacement cost coverage (EARTHQUAKE & FLOOD)	\$1,000,000 each loss 5% subject to min, \$1,000,000	\$200,000,000 \$100,000,000
BOILER & MACHINERY	\$50,000	\$50,000,000
COMBINED LIABILITY (including general liability, auto, professional liability, medical malpractice, director & officers etc.)	Self insured	
WORKERS' COMPENSATION	Authorized Self Insured Employer	Statutory Benefit
MARINE Vessel Hull & Machinery Marine P&I Legal Liabilities Marine Pollution	\$750,000 \$500,000 \$500,000	Declared Values \$500,000,000
FOREIGN LIABILITY	NIL	\$1,000,000
AVIATION LIABILITY Airports Aircraft	\$250,000 \$250,000	\$500,000,000 \$25,000,000
EMPLOYEE FIDELITY BOND incl. blanket faithful performance and statutory bond coverage	\$500,000	\$25,000,000

This list is not detailed and does not include all policies for special exposures — there are policy extensions and limitations not included in this statement — additional information concerning specific areas of coverage is available from Risk Management on request. These policies extend to cover all State Departments except those specifically excluded such as the Alaska Railroad, University of Alaska, and AHFC who administer their own insurance programs.

2) Claims Adjusting and Litigation Management

By assuming all normal expected accidental loss, the State is able to optimize the cost efficiencies of a self-insurance program and to directly control the defense and settlement of its claims. Using independent insurance adjusting firms located throughout the state, Risk Management is able to provide prompt investigation and fair settlement of liability claims filed by the public and to give all injured state employees and their dependent's timely receipt of any benefits owed under workers' compensation statutes. Replacement cost funding is immediately arranged for prompt repair or renewal of state property and equipment that is damaged or destroyed.

Harbor Adjustment Service – Anchorage is the state's third party claims administrator for all workers' compensation injury and illness claims filed by state employees. They also adjust auto, general and airport liability claims as assigned by Risk Management.

Risk Management claims administrators oversee and manage the day-to-day activities of all independent professionals handling state claims. Through an on-line interactive claims information system they are able to immediately determine the current status of any case and view all payment and reserve transactions. Large or precedential claims are closely monitored through detailed narrative status reports with direct supervision and control by the state. Risk Management performs on-site claim audits, sampling randomly selected claim files to ensure prompt professional and cost effective claims services are continually provided.

For litigation cases, Risk Management funds the Special Litigation (Torts) Section within the Department of Law, presently fourteen assistant attorneys general, eight paralegals, and seven legal secretary positions. Using state-employed defense attorneys is clearly the most cost effective and operationally efficient method to handle all civil litigation and workers' compensation caseload protected by the Risk Management program. When a conflict of interest arises or if the current caseload demands it, a private defense counsel is retained by individual professional service contract with authority of the Department of Law.

Risk Management claims staff works closely with Department of Law legal staff on defense or settlement decisions in all complex claims and litigation cases.

3) Contract Review

A vital and basic cornerstone in any comprehensive Risk Management program is the transfer of the risk through careful consideration of terms and conditions used in all State contract agreements (supply, service, lease, construction, and professional) to identify just a few. Indemnification (hold-harmless) and specifically relevant insurance requirements are necessary to protect the State from being held legally responsible to pay for the negligent acts of independent contractors and other parties with whom the State has written contracts. Due to the wide variety of contract forms, it is not possible to adopt a single standard or uniform format. Risk Management has developed boilerplate forms (Appendix B1 and B2) to be used by State contracting officers as guidelines in professional service agreements. Modifications are made on an individual request basis, tailoring the final terms to the unique activities of that agreement, considering availability and affordability of the requested insurance coverage.

4) Cost of Risk Allocation

Risk Management's budget is funded entirely through inter-agency receipts annually billed each agency through a "Cost of Risk" premium allocation system (CORA). The Risk Management information system generates the annual cost of risk allocation to each agency reflecting their proportionate share of the State's overall cost of risk. Designed to achieve equitable distribution of the self-insurance program costs — it factors exposure values subject to loss and considers the past 5 years actual claims experience incurred by each department. For most cost of risk allocations, 80% of the premium billing is based on the average of the past 5 years-actual claims experience. Thus provides a direct fiscal incentive to each agency to reduce or control their claim costs.

The program compiles a property inventory schedule of all owned or leased buildings used or occupied by State agencies; recording age and type of building construction, occupancy, fire protection services and sprinkler systems and projected replacement cost value. Individual premiums are then determined and in cases of multiple occupancy — allocated to each department on the basis of square footage used.

The following exhibits detail FY2010 premium allocations for general liability and workers' compensation billed to each department. Additional breakouts to a second tier divisional or institutional level are now being generated. This demonstrates to each agency those units generating claims costs and assists in accurate and equitable distribution of the RM annual cost of risk allocation within each department. For greatest accuracy, exposure component detail (payrolls, personnel, vehicles etc.) needs to be configured to the same locations or divisional units used for claim location identification. Risk Management continues to work with each agency to develop this information to improve the value of these reports to better assist management comparisons of similar units and operations.

The "cost of risk" premium is collected through two methods from individual state agency operating budgets. Reimbursable Services Agreements (RSA's) are used for all categories of insurance other than Workers' Compensation and Combined Liability (general, auto and

professional) which are assessed on a rate per \$100 payroll - applied monthly to each agencies actual payroll until the allocated premium is paid. As each agencies payroll generates the premium owed the assessment is individually shut off.

The FY2010 actual rates used for payroll deductions are presented, comparing them to FY09 rates.

5) New Federal Reporting Requirements (CMS)

Starting March 1, 2010, RM will be required to report certain qualifying claims to the Federal Center for Medicare/Medicaid Services (CMS) offices. CMS requires their interests be protected prior to any settlement of the medical portion of a claim for qualified individuals.

Penalties for noncompliance are \$1,000 per claim, per day.

CMS regulations apply to self-insurance plans as well as insurance companies.

RM is working with the software database vendor in order to be able to meet the deadline.

FY2010 Issues

Risk Financing:

Obtaining adequate financing to meet the ongoing demands of the State's comprehensive self-insurance program remains the highest and most prominent issue for Risk Management (RM). Exclusively funded by interagency receipts, RM pays all claim settlements and defense costs as they are due and payable, drawing from the Catastrophic Reserve Account (CRA) whenever there is insufficient appropriation to meet ongoing claim obligations.

This account is annually refilled by two methods. First, any remaining RM operating appropriation is transferred into the account. Second, a year-end "sweep" of unexpended lapsing state general funds from other state agency operating budgets may be collected if there is less than a \$5 million unencumbered balance in the fund at fiscal year end. In FY07, RM's appropriation was adjusted upwards to recognize the "true cost of risk" expenditures –avoiding the prior practice of seeking significant tort claims funding in the Department of Law's judgment and claims bill combined with additional supplemental appropriation requests to address claim obligations.

Increased construction replacement costs valuations and world reinsurance and excess markets escalations for catastrophe modeling of earthquake risks as well as overall loss adjustments for recent world catastrophe loss costs continue to challenge the Risk Management (RM) property insurance program. For FY09 RM increased per occurrence policy limits to \$200 million for all perils except quake and flood. FY2010 market conditions did allow RM to maintain this limit.

1. As required by Alaska Statute 37.05.287 (b) an independent casualty actuary annually estimates future payments of loss and allocated loss adjustment expense for the State of Alaska's self-insurance program. In their report dated September 24, 2009, ARMTECH estimate expected claim payments in FY2010 to be \$30,602,000 and predict the state will ultimately pay \$85,050,651 (using Expected Confidence Level) for outstanding losses as of 6/30/11– see the following exhibits on page 12 and 13. These projected future payment obligations are reported as un-funded liabilities in the state's comprehensive annual financial report filed by the Division of Finance.
2. The following two exhibits; C-1, and C-2 are pages from the September 24, 2009 ARMTECH Annual Actuarial Report.

The total estimated outstanding losses at various confidence levels are as shown in Tables III-1B and III-1C.

Table III-1B
Estimated Outstanding Losses
at Various Confidence Levels
June 30, 2009, June 30, 2010 and June 30, 2011

Confidence Level (1)	Estimated Outstanding Losses as of 06/30/09 (2)	Estimated Outstanding Losses as of 06/30/10 (3)	Estimated Outstanding Losses as of 06/30/11 (4)
(A) Expected	\$72,904,315	\$78,486,194	\$85,050,651
(B) 75%	91,130,394	98,107,743	106,313,314
(C) 85%	103,524,127	111,450,395	120,771,924
(D) 95%	126,124,465	135,781,116	147,137,626

Note: (A2), (A3) and (A4) are from Tables III-1A-01, III-1A-02 and III-1A-03.
(B), (C) and (D) are based on (A) and actuarial judgment.

Table III-1C
Present Value of Estimated Outstanding Losses
at Various Confidence Levels
June 30, 2009, June 30, 2010 and June 30, 2011

Confidence Level (1)	Present Value of Estimated Outstanding Losses as of 06/30/09 (2)	Present Value of Estimated Outstanding Losses as of 06/30/10 (3)	Present Value of Estimated Outstanding Losses as of 06/30/11 (4)
(A) Expected	\$63,158,406	\$68,924,137	\$74,763,204
(B) 75%	78,948,008	86,155,171	93,454,005
(C) 85%	89,684,937	97,872,275	106,163,750
(D) 95%	109,264,042	119,238,757	129,340,343

Note: (A2), (A3) and (A4) are from Tables III-1A-01, III-1A-02 and III-1A-03.
(B), (C) and (D) are based on (A) and actuarial judgment.

The present value of the estimated outstanding losses is the estimated outstanding losses discounted to reflect future investment earnings. It is based on a 3.5% interest rate.

2. Project Ultimate Losses

We project ultimate losses for FY2010, FY2011 and FY2012 to be as shown in Tables III-2A, III-2B and III-2C.

Table III-2A
Projected Ultimate Losses
FY2010

Program (1)	Projected Ultimate Losses (2)	Present Value of Projected Ultimate Losses (3)
(A) Workers compensation	\$18,293,000	\$15,925,000
(B) General liability	7,701,000	6,857,000
(C) Marine	2,543,000	2,336,000
(D) Property	743,000	714,000
(E) Automobile liability	919,000	856,000
(F) Aviation	403,000	371,000
(G) Total (A) ... (F)	\$30,602,000	\$27,059,000

Note: (A) is from Exhibit WC-10. (D) is from Exhibit PR-10.
(B) is from Exhibit GL-10. (E) is from Exhibit AL-10.
(C) is from Exhibit MA-10. (F) is from Exhibit AV-10.

State Catastrophe Insurance Reserve Account

This fund, authorized under *AS 37.05.289*, is limited to a maximum of \$5 million, is first replenished by any lapsing Risk Management funds, and then by other agency lapsing general fund appropriation. When enacted in 1987, this fund was intended to pay only the rare large loss. As detailed above, this account has been used to pay the more frequent smaller claims when the Risk Management appropriation has been depleted.

From FY1990 through FY2008, over \$118 million has been withdrawn from the catastrophe reserve fund or by other direct appropriation to pay claim settlements — see **Exhibit A1-A6**. **Exhibit B** shows the authorized budget and actual expenditure detail for FY00 -FY2009.

Exhibits C3 thru **G** contain pie charts with graph data illustrating a breakout by department of the last 5 year (by fiscal year) cumulative loss history in workers' compensation, general liability, Alaska Marine Highway System ferries marine hull claims (by vessel), and auto liability.

Exhibits H1 and **H2**, again broken down by Department, show the frequency and severity per 100 full time employees (FTE) on an annual basis (based on actual paid costs). For FY2009 the frequency and severity levels show a slight increase per 100 FTE's from the previous year, even though the prior 4 years have shown slight decreases. We continue to find that each department has an interest in and pay close attention to the management of their workers' compensation risk exposures.

Exhibit J will show the cost per hundred to insure the State of Alaska property. This exhibit shows Risk Management has been able, through our broker, to keep the cost per/\$100 of value at a very low level during the past 5 years.

The Risk Management information system is capable of generating many varied forms of analytical reports that can demonstrate costs per line of coverage, loss patterns, cause of accidents or injury trends. The staff would be glad to respond to any request for customized reports or specific information tailored to the needs of individual agencies.